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Arbeitsstelle für Entwicklungsländerforschung

**BAITUL QIRAD:  
Reconstructing Islamic Cooperatives in Aceh, Indonesia<sup>1</sup>**

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*Advisor, GTZ Economic Recovery and Microfinance Aceh*

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*“I think that we have to have an unshakable commitment to building back these areas better than they were before. I don't think it's acceptable just to replace what was destroyed. The human price these people have paid alone argues for a commitment to better, safer housing, better schools, better health care facilities, better governmental buildings and, hopefully, a more diversified economy that will generate higher incomes and be less subject to radical disruption.”*

Kofi Annan, 13 April 2005

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<sup>1</sup> Paper presented at the European Microfinance Week, *Strengthening MFIs in Developing Countries*. Luxembourg, 29 Nov – 1 Dec

## **I. BACKGROUND**

The tsunami on 24 December 2005 caused major devastation in almost every sector in the Indonesian province of Nanggroe Aceh Darussalam. However this is not the main challenge of reconstruction of microfinance sector in Aceh, because even before the tsunami the sector has been under developed due to 30 years of political and military conflict.

Economic recovery and microfinance is one of post-tsunami rehabilitation and reconstruction programs between the government of the Federal Republic of Germany and the Republic of Indonesia in the province of Nanggroe Aceh Darussalam. The program is conducted jointly by the German Technical Cooperation (GTZ) and the Indonesian central bank. The overall objective of this Project is to improve the supply of the poor and low income households in NAD with financial services through rural bank/people's credit bank (*Bank Perkreditan Rakyat / BPR*) and other selected microfinance institutions (MFIs) in order to strengthen and support the micro- and small enterprises (MSE) sector. One element of microfinance institutions to be supported is Islamic financial cooperative (baitul qirad/BQ).

## **II. ISLAMIC FINANCE IN INDONESIA**

As the largest Moslem country in the world, the development of Islamic finance in Indonesia was started too late compare to other contries. The development of Islamic finance was actually started on 1992, when Bank Muamalat Indonesia (BMI) was established as the first Islamic Bank in Indonesia. The establishment process was supported strongly by the government. There was a community gathering in Bogor, West Java lead by President Soeharto to raise the initial capital of the bank.

As the first and the only Islamic bank at that time, BMI had to face the strong competition. The market did not respond positively to this new alternative bank. People saw BMI as a "social bank" rather than a commercial bank. Furthermore, due to limited capital BMI was having problem to expand the network. But when the economic crisis came and destroyed the banking sector on 1998, BMI could still stand firmly showing the real meaning of Islamic banking. This triggered the establishment of new Islamic banks as well as Islamic units of conventional banks. By the end of 2005, there were 22 Islamic banks including 19 Islamic units. The total asset of Islamic banks

was counted almost IDR 21 trillion which was covered around 2% of the asset of the whole commercial banks. The financing deposit ratio (FDR) was 97.8% which was much higher than the loan deposit ratio of conventional bank, which was around 30%. The central bank estimated that in 2008 the total asset of Islamic banks will reach 5% of the asset of the banking sector.

The rapid development of Islamic banking can also be seen in microfinance sector. Microbanking in Indonesia is served formally by two kinds of institution namely people's credit bank (Bank Perkreditan Rakyat/BPR) and cooperative. In 1994 national organizations, ICMI<sup>2</sup> and PINBUK<sup>3</sup>, jointly promoted the BMT<sup>4</sup> movement as an alternative model of microfinance institution. The government also supported the movement by declaring the establishment of 10000 BMTs all over Indonesia. It is followed by creating network between BMI, Islamic BPRs and BMTs. Later on the network was not working very well because of the limited capital and branch offices of BMI and BPRs as well as low management capacity and weak institution structure of the BMTs.

Both problems of the BMT was mainly caused by the instant and top down development approach and unclear institution model. BMT did not have legal status but it has to be registered with PINBUK, which was not a part of government authority. On the other hand, to create network with banks a legal status is needed. Therefore many BMTs were registering themselves as cooperatives. Because actually from the beginning BMTs were not aimed to implementing cooperative principles then most of them are failed to become real cooperatives. Instead of serving their members, cooperative BMTs are serving the public.

### III. COOPERATIVE SECTOR IN INDONESIA

July 12<sup>th</sup> is commemorated in Indonesia as cooperative day, as the first cooperative congress was held in Tasikmalaya in 1950. However the cooperative movement in Indonesia was initiated at Purwokerto, Central Java in 1896 by founding a bank for government official staffs. In 1908, Budi Utomo, founded by Dr. Sutomo, played the important role for cooperatives movement to make better life of society. In 1927, Islamic Trader Union (*Serikat Dagang Islam*) was founded to developed bargaining power among indigenous entrepreneur. In 1929, Indonesian National Party (*Partai Nasional Indonesia*) was founded which had activities in promoting cooperative spirit.

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<sup>2</sup> ICMI = *Ikatan Cendekiawan Muslim Indonesia* (The association of Indonesian Moslem intellectuals)

<sup>3</sup> PINBUK = Pusat Inkubasi Bisnis Usaha Kecil (The centre of the incubation of small scale business)

<sup>4</sup> BMT or *Baitul Maal wa Tamwil* is an Islamic microfinance institution, which functions as *baitul maal*, an organization collecting and disbursing social and religious funds (*zakah, infaq and sadaqah*) as well as *baitul tamwil*, an organization collecting and disbursing commercial funds. In Aceh such organization is called *baitul qirad*.

After that cooperative movement has been going through up and down situations. The movement is now facing dilemmatic situation. On one side the cooperative is believed to be a model of people's economy, but on the other hand it is still unable to improve the economic power of the people. The institutional problem is more likely as the main cause. As the result most people do not trust in cooperative anymore.

The Indonesian cooperative law obliged a cooperative to have at least 20 members to be registered. Though there are number of cooperatives having less than 20 members. There is indication that there is a motive that people establish cooperative only to get legal/formal status of their business since it is easier than a limited company. Due to the motive, the "owners" are likely not willing to expand the membership, as they do not want to loose the control over the institution.

Concerning there is "one man one vote" rule, cooperative is the reflection of democracy in the economic sector. The rule ensures equal partnership among members. Unfortunately the supervision system is still weak in Indonesia. As the result most cooperative are failed to perform democratic values because of the domination of one or some individuals. Many cooperative failed to have regular general assembly and the members of board are unchangeable.

Economic activity should be the reason of the establishment of cooperative. However it is common to find that the establishment of cooperative is conducted in order to obtain funds from donors (government) and there are no economic activities conducted after receiving the funds unless sit and wait for the next donors (government) program. As the result, the cooperative is not able to increase the economic growth of the area because it does not perform any economic activities.

The autonomous principle is illustrated by that cooperative has to be established by the members, managed and controlled by the members and for the sake of the members as well. The government program which is actually intended to promote cooperative might diminish its autonomy especially when it comes to financial assistance. Such intervention is likely to create spoiled cooperatives and also to invite free riders. This creates other motive of establishing cooperative, namely to acquire government fund for the benefit of some irresponsible person.

As indirect impact of the situation, people are no longer believe in cooperative and do not feel their ownership in it as the next principles education and training is also neglected. People seem does not trust in a cooperative anymore. People who are already member of a cooperative refuse to continue paying the compulsory saving whereas others refuse to join in.

The mechanism of networking and cooperation among cooperatives is still weak in Indonesia. Although there are few good cooperative associations or secondary cooperatives, but most of them are still weak. The worst part is there are number of cooperatives which do not belong to a secondary structure or just stand alone.

Cooperative should be established by a community which has a common bond in order to increase the prosperity. As the consequent the community must also liable for the growth of the cooperative. But the most common practice in Indonesia, an establishment of a cooperative does not based on the motivation of the community. Consequently the relation between the cooperative and its social environment is loose or even there is no relation at all.

On the other hand, credit union is one of cooperative models in Indonesia which have fully accomplished cooperative principles. The movement was started more than 35 years ago and still able to maintain its independency and self governance. The credit union movement in Indonesia was promoted by Catholic Church in its early stage. Although currently there is other communities promoting credit union, but its catholic image cannot be loosed. This might be the reason why its development in Indonesia is not overseen.

#### IV. RECONSTRUCTING ISLAMIC COOPERATIVE IN ACEH

Despite Of the institutional problem of the cooperative sector in Indonesia, the cooperative model has proven as one of the most robust and least-cost models of decentralized financial intermediation. In the more remote parts of Aceh, this decentralized microfinance model has a clear scope for replication especially due to its geographical condition.

There are two operational models of financial cooperatives. Single purpose cooperatives specialized in providing financial service (saving and loan) for the members and multipurpose cooperatives which do not have specific business although might also have saving and loan units. There are only 11 saving and loan cooperatives in Aceh in 2003 compare to 1,042 saving and loan units.

		KSP		USP	
		Total	Average	Total	Average
<b>Number of units</b>	<i>Unit</i>	11.00		1,042.00	

<b>Number of members</b>	<i>Person</i>	1,391.00	126.45	174,937.00	167.89
<b>Own Capital</b>	<i>IDR Million</i>	219.42	19.95	34,280.00	32.90
<b>Loan Capital</b>	<i>IDR Million</i>	188.20	17.11	17,859.00	17.14
<b>Savings</b>	<i>IDR Million</i>	60.61	5.51	4,263.00	4.09
<b>Loan-able Funds</b>	<i>IDR Million</i>	468.23	42.57	56,402.00	54.13
<b>Loan</b>	<i>IDR Million</i>	615.40	55.95	65,451.00	62.81
<b>Asset</b>	<i>IDR Million</i>	684.12	62.19	65,739.00	63.09
<b>Dividend</b>	<i>IDR Million</i>	11.50	1.05	4,111.00	3.95

Source: Cooperative Office of Aceh

Table 1. Saving and loan Cooperatives/Units in Aceh (2003)

The study and mapping conducted by the German Development Cooperation through GTZ Economic Recovery and Microfinance in Aceh shows that the cooperative system in the province is still underdeveloped. Related to the quantity, the density of cooperative is very low, namely 1 cooperative per 2,717 population. Related to the performance, more than 60% has a poor financial performance, about 15% have a poor management capacity and only 37% have a good institutional structure. Thirty years of conflict is widely accepted to be a main cause of this. But institutional problems are likely to be the primary cause, or an equally significant cause, as the same problems also exist in other parts of Indonesia.

Although cooperatives are unpopular on the grassroots level, a microfinance institution called *Baitul Qirad* was introduced in 1994 in Aceh. There are 43 baitul qirads established and supported by PINBUK during 1994-1995. On October 2006 there are 36 baitul qirads across Aceh and 32 of them belong to the network of PINBUK.

Together with German Development Service (DED), GTZ conducted assessment of 5 largest baitul qirads in Banda Aceh. The assessment was able to identify several characteristics of the baitul qirads that can be seen on the following table.

	<b>STRENGTH</b>	<b>WEAKNESS</b>
1.	All are registered as cooperative (multi-/single purpose)	Lack of awareness of the legal framework or statutes
2.	Having a lot of pre-members (clients)	Mostly pre-members, who don't pay membership fee
3.	Offering wide enough range of products	The 'compulsory' savings are withdrawable anytime
4.	Operating on high potential market with tight relations through loan officers	Improper bookkeeping / accounting (on-balance/off-balance positions)

5.	Having continuous bookkeeping.	No reserves are foreseen and realized
6.	Low number of high internal loan	Focus on grants through donors
7.	Offering internship	

Table 2. The Strengths and Weaknesses of Baitul Qirad in Aceh

Although BQs are registered as cooperative but they are serving the publics (pre-members). According to the cooperative law, after 6 months all pre-members should become full members. But due to the lack of supervision of the cooperative authority (cooperative office) the BQs are not able to force them to become full members. As the result the financial structure becomes weak. The BQs are not able to mobilize internal capital and strongly depend on grants.

As an Islamic microfinance institution, BQ operates not only on a commercial but also on a social basis. It can manage commercial and social funds / religious taxes and donations (*zakat, infaq and sadaqah*). This unique characteristic develops a mutual relationship between BQ and its community, which might be the reason for its sustainability in Aceh. Furthermore Aceh is a province in which the culture is strongly influenced by Islamic values and it has been implementing *sharia* law since 2001. These factors indirectly also promote the development of the *sharia* financial system. So instead of using the name of “Cooperative”, the Islamic cooperative is reintroduced to the people of Aceh using the name of “Baitul Qirad”. All common terminologies in the cooperative sector are changed. This new image along with *sharia* financial mechanism, gives an opportunity to regain the trust of society as well as to enhance development of the cooperative sector in the province.

Taking the current conditions of the BQs into account and learning from the success of credit union in other part of Indonesia, the challenge in Aceh is how to reconstruct the BQs so that they can perform the cooperative principles properly using the credit union as the benchmark. In other word, baitul qirad is expected to become the Islamic credit union in Aceh. Consequently the reconstruction of the sector must be performed using holistic approach as can be seen on the following figure.



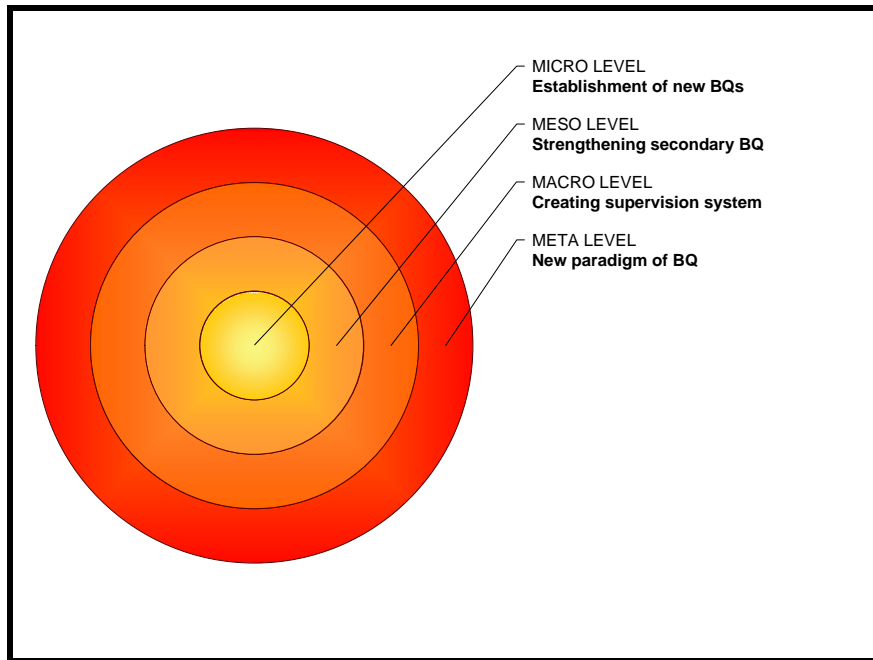


Figure 1. BQ Development Approach

#### IV.1. MICRO LEVEL STRATEGY

Based on the Cooperative Principles, GTZ (on behalf of the German Government) assists the Islamic cooperative sector in Aceh on various levels. On Micro level numbers of new baitul qirad will be established across the province. Establishing new baitul qirads is preferred rather than to revitalize the old ones since the cost is lower and the result is expected more efficient. Furthermore there are still large areas which are not yet served by microfinance institutions. The new BQs are expected to enlarge the areas which are served by microfinance institutions.

The establishment process of the two pilot BQs was conducted jointly by the German Technical Cooperation with PT. Permodalan Nasional Madani (PNM), a state own corporation for small and medium scale enterprises, and financed by Allianz AG. The process was started on September 2006 to identify potential location. Two start-up locations were proposed for immediate action: sub-district Muara Batu in Aceh Utara and Sub-district Jeunib in Bireuen.

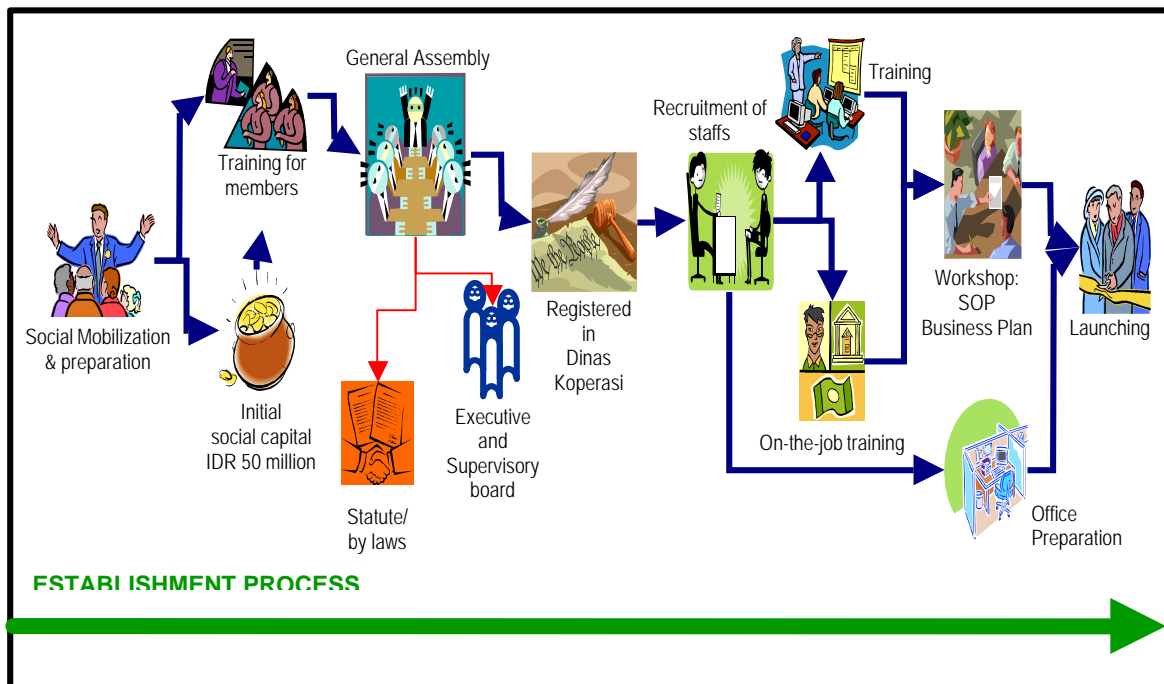


Figure 2. Flow establishment of Baitul Qirad

On December 2006 the head of both sub-districts gathered the community leaders to disseminate the idea of self managed Islamic cooperative. It came to the conclusion that the people will initiate the establishment of a new BQ by raising social capital IDR 50 million. It took 2-3 months to achieve the defined amount collected from numbers of people, who are registered as founding members. After that, the first general assembly was held to formally establish the cooperatives as well as selecting members of advisory and executive boards. Technical assistance would only be given when the people have collected the initial social capital (IDR 50 million) and obtained the legal status of a saving and credit cooperative. This is intended to ensure a BQ which has a strong membership, is democratic and is also autonomous.

The technical assistance covers education and training for members, boards, supervisory board and management in order to establish a basis of institutional learning. The training covers cooperative principals, Islamic finance, banking, financing analysis, marketing, as well as personal and team building. After obtaining the legal status, together with GTZ and PNM, the executive board selected and recruited managers and staffs for the BQ. 10 persons (5 persons per BQ), who mainly come from within the sub-district have been recruited. They have to undergo serial of classical and on the job training. On the job training was conducted in two stages. In the first stage, they were placed in 2 (two) BQs in Banda Aceh and in the second stage,

accompanied by one of the executive board member, they were placed in 2 (two) Baitul Maal wa Tamwil in Bandung (West Java).

After the training, GTZ and PNM facilitate Standard Operating Procedure Workshop which attended by all of executive board, managers and staff. The aim is to create manual for daily operation as well as adjusting the standard IT system with the manual. The adjusted IT system then is installed along with the procurement and finishing the office space.

Both BQs were formally launched on 15 September 2006. Despite of Ramadhan and Idul Fitri, on 24 November 2006 the asset of BQ Jeunib was reported IDR 176 million. The capital has increased from IDR 50 million to 58.4 million and the total amount of saving was IDR 11.5 million where as financing was IDR 7.8 million. Number of members is also increasing as 170 new members are reported. BQ Muara Batu was reported having IDR 192 million assets per 24 November 2006 with IDR 5 million financing and IDR 11.2 saving account as well as 43 new members. The financing is still low since both BQs provide financing only for members which have proven their commitment to the BQ for 3 months by paying regular compulsory saving.

In the second phase 6 sub districts have been selected, namely Seuneddon, Tanah Pasir, Lhok Sukon, Samudera, Cot Girek and Blang Mangat. Learning from the experience from the first phase, there are some adjustments of the process must be conducted. In this phase, prior to the general assembly GTZ provides training for all founding members regarding cooperative principles and sharia banking. Furthermore a small workshop attended by the board also facilitated to prepare a better and more comprehensive statute and by laws.

#### **IV.2. MESO LEVEL STRATEGY**

Establishing a secondary structure is the focus on the meso level. On August 2006 the first workshop on the strategy of the establishment of secondary structure was held in Banda Aceh, attended by 18 BQs from 4 districts, namely Banda Aceh, Aceh Besar, Lhokseumawe and Aceh Utara. A cooperative expert from Indonesian Credit Union and a practitioner of a secondary structure of Baitul Maal wa Tamwil were also invited as resource person. Through the workshop, the primary BQs identified the necessary of a secondary structure for their performance. The workshop was also able to figure out the projected legal form of the secondary structure and bring out the agreement of the BQs to have regular informal meeting during the establishment process. In the conclusion, there will be 2 (two) secondary BQs to be established, one in Banda Aceh and the other one in Aceh Utara.

The network of baitul qirad proposed by the participants BQs can be seen as follows:

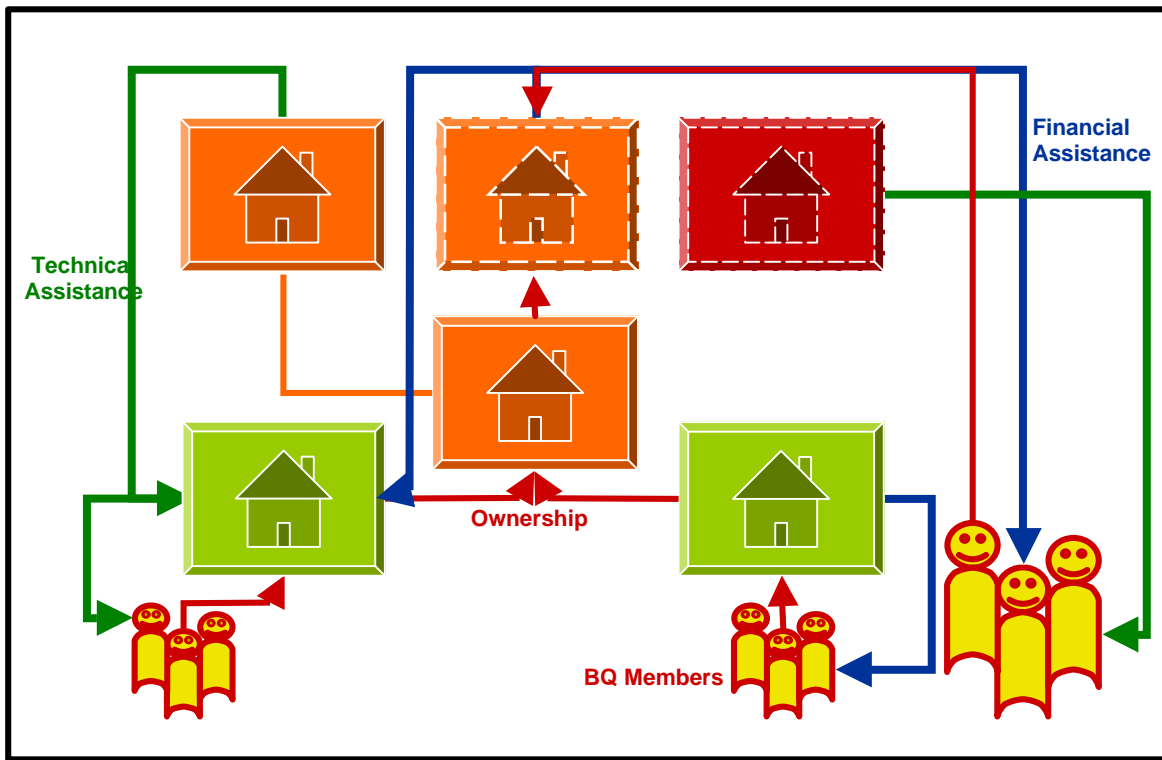


Figure 3. The Network of Baitul Qirad (Jama'ah Baitul Qirad)

Baitul qirads will create the secondary BQ. In addition the minimum requirements for BQ to be able to join in will be created as well. The secondary structure then will form a special service unit, called BQ Center, to provide necessary services for the primary BQs. It is expected that the BQ Centre will become the development centre for BQs by providing training and other necessary non-financial services for members such as counseling, auditing, rating and supervising. Through the secondary structure and its BQ Center, a better network and better cooperation between BQs is expected to be strengthened. Furthermore it will also provide more space for the BQ sector to autonomously manage and sustain control.

For financial support, it appeared from the workshop that the secondary structure will be also responsible for executing or channeling donor's fund to its members based on the individual capacity. The secondary structure will also manage inter-lending among its members and function as lender of the last resort. In the future this function is expected to be done by a people's credit bank which is owned by the secondary BQ and individual primary BQs. The people's credit bank will also be able to finance the members of primary BQs based on the reference of the respective BQ, when the financial need is already beyond the capacity of the BQ.

To increase the capacity of members of primary BQs, cooperation with Business Development Service Provider (BDSP) will be developed. Giving an incentive for the members to use the service of the BDSP will also increase the sense of belonging of the members to the Islamic cooperative system.

#### **IV.3. MACRO AND META LEVEL STRATEGY**

The Ministry of cooperative and small medium enterprise is acting as the facilitator of the cooperative movement in Indonesia. On the district level the responsibility is on the hand of the cooperative office (Dinas Koperasi). The main task of the cooperative office is to monitor and supervise the performance of financial cooperative. However it is not working well due to limited number of staff and capacity.

On the macro level close cooperation with Cooperative office (Dinas Koperasi) is enforced especially on the district level. The cooperative office will be always involved in every activity on micro and meso level. Parallel with that number of activities to expand the knowledge of the dinas staff is also conducted such as exposure training.

The holistic approach is expected to improve the meta level by regaining society's trust in the cooperative sector as the sector will have a new brand name as baitul qirad as well as operational paradigm based on the Cooperative Principles. Promotion of baitul qirad as Islamic cooperative is enforced in various occasion including thorough articles in mass media.

#### **V. SUMMARY**

As member based organization, the establishment of a cooperative cannot be induced by external actors. What one can do is to motivate people to establish a cooperative but in a positive way, e.g. not by offering a "lollypop". The people should decide by themselves how they will establish it and let them select their own representatives on the board. However considering that cooperative has bad reputation in Indonesia, the understanding of the cooperative principles should be disbursed to all members from the beginning. On the other hand the existing baitul qirads should be enforced to implement cooperative principles gradually.

Because of its complex problem and to ensure the sustainability of the system, the holistic approach must be taken. Development of secondary structure will bring out the autonomous structure of baitul qirads. The secondary structure will responsible for the supervision and capacity development of the baitul qirads. It is expected, that all donors should go to the secondary structure instead of go directly to primary baitul qirad. Therefore coordination with cooperative office as the largest donor must be applied to introduce it to the structure.

In the case of Aceh, baitul qirad as the new “brand name” along with renaming all cooperative terms are very effective in attracting people to join in. It is expected that the new name can trigger of the regaining trust of the society in the cooperative system. Furthermore a standardization and certification should also be implemented to maintain and ensure best quality.

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***Banda Aceh, November 2006***